



STATE OF ILLINOIS
Illinois Commerce Commission

CHARLES E. FISHER
EXECUTIVE DIRECTOR

August 4, 1998

527 E. CAPITOL AVENUE
P.O. BOX 19280
SPRINGFIELD, ILLINOIS 62794-9280
FAX (217) 782-1042

The Honorable John D. Dingell
U.S. Congressman
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515-6115

Dear Congressman Dingell:

Thank you for your recent letter to Chairman Mathias requesting comments on the recent events in the wholesale electricity market. Chairman Mathias has asked me to respond to your letter since the matter in question touches the subject matter of ongoing Commission proceedings filed by the Illinois Attorney General.

The Commission is reviewing the impact of the events of late June on retail customers. We are also very aware of the impact of the wholesale price spikes on individual entities and the wholesale market.

In response to your letter of July 15, 1998, regarding the recent volatility in electricity markets, I have provided as an attachment understanding of the events which led to the market anomalies which occurred in the latter part of June. In the attachment, Commission staff has repeated, in bold type, the specific questions you asked and included my responses just below those questions.

If our comments generate further questions on these matters, please feel free to contact me directly.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles E. Fisher".

Charles E. Fisher
Executive Director

Attachment

- 1. Please outline your understanding of the course of events leading to supply curtailments and price surges in electricity markets during the week of June 22, including any gaps in your understanding of the relevant factors.**

There are a number of individual events and factors which contributed to the electric power shortages in late June. Two Illinois nuclear plants, Commonwealth Edison's ("Edison") LaSalle and Illinois Power's ("IP") Clinton, were not operating because of Nuclear Regulatory Commission ("NRC") constraints, and one Illinois nuclear plant, Zion, was not operating because its owner, Edison, has closed it for economic reasons. In addition, other nuclear plants outside Illinois, such as the Cook plant in Michigan and the Davis Besse plant in Ohio, were not operating because of NRC constraints and weather factors from severe storms affecting transmission capability. The weather on June 24 began to turn very hot and humid and that situation extended over a large part of North America. Numerous electric utilities across the Midwest and East faced near all-time peak demands and were unable to fulfill power sales commitments. Certain utilities had relied for planning purposes on power supplies and transmission availability to meet their power demands, but found that those commitments were not actually met when the weather required that the commitments be fulfilled. Overall, the relevant generation supply factors were discussed in the May 1998 report of the North American Electric Reliability Council, entitled "1998 Summer Assessment -- Reliability of Bulk Electricity Supply in North America."

- 2. Are you considering initiating, or have you already begun, an inquiry into these events? If so, please describe the purpose, scope, and timetable for completion of any such proceeding.**

Parties, including the Illinois Attorney General, have, following the end of the power shortage in late June, filed complaints with this Commission which request certain relief for retail customers from the Commission. This Commission has not initiated any formal inquiry or proceeding into the wholesale power events of late June. However, Commission Staff have been in nearly constant contact with Illinois electric utilities since April of this year, and the Commission convened sessions in May, June and July to receive presentations from utilities about the developing and ongoing electricity supply situation.

- 3. Are you seeking, or participating in, any such proceeding undertaken by another organization?**

The Commission is aware of the Cinergy petition filed with the Federal Energy Regulatory Commission ("FERC"), (EL98-53-000), in which Cinergy has urged FERC to convene a conference to examine the circumstances of the electricity market in the Midwest during late June, and the Steel Dynamics petition at FERC, (EL98-54-000), in which FERC has been requested to investigate the electricity capacity and supply situation in the Midwest in late June and the reasons for the very high electricity prices and whether refunds are due, and for other relief. The Commission is also aware of an investigation initiated by the Ohio public utility commission.

The FERC is particularly well-suited to investigate the late June electric market situation. The national scope of the phenomenon is one which only a Federal body can appropriately

examine. The Illinois Commerce Commission will continue to monitor the two previously-mentioned FERC proceedings and may become involved as necessary and appropriate in those proceedings.

4. Do you consider the price spikes and supply shortages in the Midwest during June to be a one-time event, or might they recur? Are you concerned about the remainder of the summer, and what are the factors affecting near-term market reliability? If you think a recurrence of market turbulence is possible, do you believe changes in market structure or regulation may be needed?

The supply and demand conditions which resulted in the price spikes in the electricity market in late June were rare, but they could happen again. The price spikes could be an entirely reasonable and justifiable market response to a shortage of a critical commodity for which there are no storage facilities.

Critical supply problems did not arise during the summer of 1997 because the national and Midwest weather never placed severe demands on the national electric grid. It is unlikely that the circumstances which have existed in the Midwest since at least before the summer of 1997, that is, insufficient electricity supply and inadequate transmission import capability in situations of supply limitations and very high demand, can be alleviated during the remainder of this summer. Supply problems may be alleviated in Illinois before the beginning of next summer if Edison and IP are able, as they have indicated they are planning, to bring their nuclear generation units back into operation. The transmission limitations which have contributed to the problems this summer when transmission capability was limited because of storm damages will not be eliminated however, since there is no significant new transmission construction being planned. However, since late June, several market participants, notably the Illinois utilities most negatively affected by price spikes, have taken additional steps in the nature of securing additional firm supplies to reduce the potential impact of such supply and demand crises during the remainder of this summer. As market participants become more sophisticated over time, there are other measures which could be taken, such as better use of risk management techniques and strategies and increased attention being paid to the actual power supply and delivery capability of other market participants. In addition, more attention may be devoted by utilities to innovative strategies which can reduce their peak loads in times of supply shortages: the two Illinois utilities most negatively affected by the supply shortages, Edison and IP, have already offered their customers tariffs and other programs which may be successful in curbing power demand in critical situations.

5. Are you aware of any complaints alleging market manipulation or conflicts of interest involving regulated utilities or other market participants?

The Illinois Commerce Commission is aware of the Cinergy and Steel Dynamics petitions filed with FERC, and the Ohio proceeding, all mentioned previously, but not of other proceedings. The Commission is also aware of the intervention of IP in the Cinergy proceeding, alleging that certain improprieties occurred in the energy markets during late June.

6. What, if any, direct or indirect effects on consumers resulted, or may yet result, from the price and supply disruptions in the Midwest in late June? Are residential customers more or less vulnerable than industrial customers, in terms of price increases and reliability of supply?

The two Illinois utilities most affected by the market price spikes in late June were Edison and IP. However, both of those utilities had eliminated their fuel adjustment clauses earlier during 1998. As a consequence, the prices their customers pay for power will be unaffected by the elevated market prices.

There is no reason to believe that residential customers will be more affected in terms of price increases or supply reliability than industrial customers. In fact, since many large industrial customers have been buying power from utilities for years under interruptible tariffs, and had their power interrupted during late June, those customers were more significantly affected by the high market prices for power than residential customers.

7. What if any effects did this market volatility have on public power entities and their consumers?

The Illinois Commerce Commission does not regulate public power entities, and therefore, is unaware of the potential impacts of the market volatility on their operations. However, if their prices to their customers are reflective of the prices at which they purchase power, there certainly could be an effect.

8. Do you foresee any lessons to be drawn from this experience for state or federal legislators deliberating the merits of electric restructuring legislation? How would more widespread retail competition affect market stability in the future, and how would residential consumers be affected? Are markets ready to make a smooth transition to full retail competition now, and should Congress pass legislation to compel states to adopt competition?

At this point, the facts about the late June market behavior are far less well known than the claims about the facts. The investigation which FERC has planned into the situation could be very useful in sorting out facts from fictions and claims. Whether the market failed or operated successfully in responding to the supply and demand circumstances is far from clear. When the facts are known, it will be time to assess the merits of additional restructuring legislation. There is no reason at this point to conclude that the events of late June clearly indicate that further restructuring or less restructuring is appropriate.